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In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 764

BUDD INTERNATIONAL CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 495–522) is reported in 45 B. T. A. 737. The original opinion of the Circuit Court of Appeals (R. 540–554) is reported in 143 F. 2d 784, and its opinion on rehearing (R. 563–568) is reported in 143 F. 2d 792.

JURISDICTION

The judgment of the Circuit Court of Appeals after rehearing was entered on July 17, 1944 (R. 569). By order of this Court entered on October 11, 1944, the time for filing a petition for certiorari was extended to and including Decem-

ber 16, 1944 (R. 571). The petition for a writ of certiorari was filed on December 16, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the taxpayer's evidence compelled the Tax Court to find that the cost of property acquired by the taxpayer in exchange for a part of its stock in 1930 was $3,000,000, or any other sum in excess of the cost originally used by the taxpayer in its returns and accepted by the Commissioner.

2. Whether the provisions of the taxpayer's articles of incorporation and its preferred stock certificates, to the effect that cumulative dividends must be paid upon preferred stock before dividends could be paid upon common, constitute a written contract which prohibited the payment of dividends within the meaning of Section 26 (c) (1) of the Revenue Act of 1936.

3. Whether the petition presents any other important question regarding the taxpayer's undistributed profits tax, the Circuit Court of Appeals having remanded the case to the Tax Court for findings necessary to a determination of the applicability of the relief provision in Section 26 (g), added to the Revenue Act of 1936 by Section 501 (a) (3) of the Revenue Act of 1942.

STATUTES INVOLVED

The pertinent statutes are set forth in the Appendix, *infra,* pp. 17–19.

STATEMENT

The pertinent facts found by the Board of Tax Appeals (R. 497–507) may be summarized as follows:

The taxpayer, Budd International Corporation, was organized on August 7, 1930, pursuant to the terms of an agreement dated April 24, 1930, between the Edward G. Budd Manufacturing Company (hereinafter called Manufacturing Company), J. Henry Schroder & Company, a London banking house (hereinafter called Schroder), and the J. Henry Schroder Banking Corporation, of New York (R. 497).

During 1926 the Manufacturing Company acquired 64% of the common shares of the Pressed Steel Company of Great Britain, Limited (hereinafter called Pressed Steel), consisting of 20,900 Class A and 17,500 Class B, at a cost of $1,000,000, and it also, by subscription, acquired 1,000 preference shares of Pressed Steel. It paid $344,458.01 of the subscription price, leaving 30% unpaid. The rest of Pressed Steel's shares were acquired by Schroder. (R. 498.) The Manufacturing Company also owned shares of Ambi-Budd Presswerk (hereinafter called Ambi-Budd) (R. 497), a German corporation (R. 498.)

On September 19, 1930, as contemplated by the agreement of April 24, 1930, the taxpayer made agreements with the Manufacturing Company, pursuant to which the Manufacturing Company transferred to the taxpayer the following property: (1) 38,400 common and 1,000 preference shares of Pressed Steel; (2) 50.59% of the outstanding common shares of Ambi-Budd; (3) royalties and other benefits to become due under license contracts between the Manufacturing Company and the Citroen automobile concern, Ambi-Budd and Pressed Steel, which the Manufacturing Company agreed not to modify or terminate; (4) all assets of the Manufacturing Company in Europe, comprising all of its European patent rights. The Manufacturing Company further promised to assign to the taxpayer licenses for the use of future patents and processes; to give advice and information on operation; to furnish the taxpayer with funds to pay the dividends on preferred shares in case its earnings should be insufficient, and to guarantee that payment; and to subscribe and pay for 3,428 more preferred and 3,428 more common shares if the taxpayer should be required to pay the additional unpaid subscription price of the Pressed Steel preference shares. (R. 498–499.)

The taxpayer issued 360,000 common shares to the Manufacturing Company and promised to pay it $344,458.01 (the amount which had been paid by the Manufacturing Company on the price of the

1,000 Pressed Steel preference shares), and to assume the obligation for the unpaid balance on the Pressed Steel preference shares (R. 499).

Simultaneously and pursuant to the agreements, the Manufacturing Company subscribed for 76,572 preferred and 76,572 common shares of the taxpayer's stock for $3,350,025. Schroder, having previously agreed to take over 68,572 shares of each class, paid $3,000,025 to the Manufacturing Company which immediately paid this amount, together with $350,000, to the taxpayer. Thereupon the taxpayer paid the Manufacturing Company $350,000 cash in accordance with its promise (the promise was to pay $344,458.01). The taxpayer then issued 76,572 preferred and 76,572 common shares to the Manufacturing Company, which simultaneously transferred 68,572 of each to Schroder. After the consummation of these transactions the Manufacturing Company held 8,000, or 10.45%, of the taxpayer's preferred shares and 368,000, or 84.29% of its common shares; Schroder held the remainder, *viz*, 68,572 preferred and 68,572 common shares. (R. 499.)

In 1935 the taxpayer approached Schroder in London on the subject of a disposition of the taxpayer's Pressed Steel shares in some manner which would yield cash. During the course of negotiations, Schroder insisted on the retirement of its shares of the taxpayer's preferred as a con-

dition of any trade with it. Schroder interested the British Pacific Trust, Limited, in a purchase of Pressed Steel common shares. On December 12, 1935, the taxpayer secured from British Pacific Trust, Limited, an option or "put" giving the taxpayer the right to demand that British Pacific buy its 332,595 Pressed Steel common shares. (R. 503.) During January 1936, the taxpayer exercised the "put" and sold the Pressed Steel common. It also authorized its officers to sell 81,667 Pressed Steel preferred to Schroder. About February 15, 1936, the transactions were consummated at Schroder's London office. The taxpayer transferred 332,595 Pressed Steel common "to Schroder and British Pacific Trust, Limited" and 81,667 Pressed Steel preferred to Schroder. British Pacific paid to Schroder and Schroder credited the taxpayer's account with $5,601,315.54 for the Pressed Steel common. Schroder also credited the taxpayer's account with $503,303.95 for the Pressed Steel preferred. The total credit left was $6,105,619.47, and a charge for expenses left a credit of $5,830,990.34 as net proceeds from the sale. (R. 504.)

Schroder and the Schroder Banking Corporation, New York, then sent to the taxpayer certificates for 68,572 shares of its preferred, and these were cancelled. The taxpayer redeemed them at the rate of $57 a share. Redemption payment was made by a charge of $3,908,604 against the taxpayer's account with Schroder. (R. 504.)

On February 17, 1936, the taxpayer's board of directors declared a dividend of $12.25 a share on the 8,000 preferred shares still outstanding and $1.50 a share on the outstanding 436,572 common shares. On March 5, 1936, the taxpayer made a further distribution of $44.75 a share in redemption of the 8,000 preferred shares which it thus acquired and cancelled. The $3.50 annual cumulative dividends on 76,572 preferred shares were in arrears from June 30, 1932, and amounted on December 31, 1935, to $12.25 a share. (R. 504–505.)

By the taxpayer's amended certificate of incorporation (R. 193–211), holders of preferred shares were entitled to receive out of surplus or net profits "cumulative dividends at the rate of $3.50 per annum and no more * * * before any dividend shall be paid or set apart upon the common stock" (R. 196). Preferred shares were subject to redemption on notice at $52 a share plus accrued dividends, and a sinking fund was required for that purpose in which the taxpayer should place each year an amount equal to 3% of the largest number of preferred shares which had ever been outstanding (R. 197–199). Holders of preferred shares were not entitled to vote at shareholder's meetings unless preferred dividends in the amount of $3.50 a share should be in arrears; if the arrearage should be $7 a share, they were empowered to demand resignation of

officers, directors and executive committeemen, sufficient in number to permit them to elect majorities (R. 200). While preferred shares were outstanding, the taxpayer was forbidden to reduce its earned surplus by any disposition to common stockholders below the lesser of (a) $120,000 and (b) net profits for 1930 and 1931, remaining after payment of preferred dividends (R. 197). These and other charter provisions relating to preferred shares were printed on the back of the share certificates (R. 323) and remained in force until the preferred shares were retired and cancelled in 1936 (R. 501–502).

Prior to 1936 the taxpayer paid no dividend on its common shares. It never created the sinking fund required for redemption of the preferred shares. Preferred dividends of $469,003.50 were paid for the period October 1, 1930, to June 30, 1932. Preferred dividends remained unpaid thereafter, and to the end of 1935 were in arrears in the amount of $12.25 a share. (R. 503.)

The Commissioner determined deficiencies of $631,006.24 and $25,296.31 in petitioner's income taxes for 1936 and 1937, respectively (R. 18). As will appear from the Argument, the Commissioner was upheld in part by the Board and the court below (R. 531, 543, 545–546, 553).

ARGUMENT

1. The taxpayer's gain on its disposition of the Pressed Steel shares in 1936, the Circuit Court

of Appeals held (R. 548–552), is to be computed by taking as a basis the cost of those shares to the taxpayer upon its organization in 1930.[1] In so holding, the Circuit Court of Appeals rejected the contention of the Commissioner that the transfer of the Pressed Steel shares to the taxpayer in 1930 was a tax-free exchange under Section 112 (b) (5) of the Revenue Act of 1936 (Appendix, *infra*, p. 18) by virtue of which the taxpayer's cost basis should be related back under Section 113 (a) (8) (A) (Appendix, *infra*, pp. 18–19) to the cost of the shares to the Manufacturing Company, the taxpayer's transferor.

By way of proving the cost of the Pressed Steel shares to the taxpayer in 1930, the taxpayer introduced evidence of the fair market value of the Pressed Steel shares in 1930. However, as the Board and the Circuit Court of Appeals observed (R. 509–510, 522), the cost to the taxpayer of the Pressed Steel shares was not their fair market value, but the fair market value of the stock of the taxpayer which the taxpayer issued in exchange for them.

The stock of the taxpayer had not been the subject of any sale, and accordingly its fair market value could not be established by resort to market price. Nor could the value of the stock

[1] The Board of Tax Appeals reached the same conclusion in its opinion (R. 508–509) but stated its conclusion as *obiter dictum*.

be measured by the value of the assets behind it; the stock was issued in exchange for a variety of assets transferred to the taxpayer by the Manufacturing Company and Schroder (R. 498–499), but the total value of these assets was not known; a large part of the assets had no value ascertainable from the record. Moreover, even if the total value of the taxpayer's common stock were known, it would still be impossible to say what value the taxpayer paid for the Pressed Steel shares; the record affords no means of knowing what part of the taxpayer's common shares was issued in exchange for the Pressed Steel shares. For these reasons the courts below both held that the taxpayer had failed to prove that its cost of the Pressed Steel shares was in excess of $1,000,000, the figure originally used by the taxpayer and accepted by the Commissioner (R. 509–511, 552–553, 565–568).

The taxpayer does not claim that there is any proof to supply the vacancies in the record held fatal by the courts below. Rather, the taxpayer asserts here (Pet. 17–18) that it is not necessary to know how many or what unit value of the taxpayer's shares were issued respectively in exchange for the Pressed Steel shares and other assets. It asserts (*ibid.*) that one may simply ascribe to the taxpayer's shares, whatever their number and value, the value of the Pressed Steel shares for which an

unknown number and value of the taxpayer's common were issued.

This reasoning pays slight service, if any, to the premise accepted by the taxpayer (Pet. 15), namely, that the question here is the cost to the taxpayer of the Pressed Steel shares. The argument necessarily assumes the conclusion—that the cost was the same, dollar for dollar, as the value of the shares received (Pet. 12, 18).

Such an assumption is hardly borne out by common experience. Here it runs directly contrary to the taxpayer's assertions successfully made below. The Circuit Court of Appeals accepted the taxpayer's contention that Section 112 (b) (5) was inapplicable to the 1930 exchange because, when the Manufacturing Company and Schroder transferred to the taxpayer the properties which came to constitute all of the taxpayer's assets, the shares issued by the taxpayer to the Manufacturing Company and Schroder were not substantially in proportion to the interest of the Manufacturing Company and Schroder in the properties prior to the exchange. Accepting the taxpayer's valuations in that respect, the Circuit Court of Appeals held that the Manufacturing Company contributed 61% of the property and received 46% of the stock, and Schroder contributed 39% of the property and received 54% of the stock (R. 551). In short, the taxpayer's

stock was not issued, dollar for dollar, for value received, and the assumption essential to the taxpayer's argument (Pet. 12, 18) is untenable.

The decision below is not in conflict with *Commissioner* v. *McKinney,* 87 F. 2d 811 (C. C. A. 10th (Pet. 24–25). There all of the newly formed corporation's stock was issued in exchange for nine oil and gas leases, each of known value, and a sum certain in cash, and the stock could readily be taken as having the same value as the assets behind it. Moreover, the properties transferred to the corporation were all transferred by one person, and the element of bargain in connection with each of the properties could be assumed to be equal, whereas here it plainly was not. The dictum (Pet. 28) in *Hunt* v. *Commissioner,* 82 F. 2d 668 (C. C. A. 5th), likewise gives no support to the taxpayer's contention. There half or practically half of the corporation's stock had been issued for cash, and the other half was issued in exchange for machinery. If the value of the machinery had been known, the value of the whole stock issue could have been ascertained, and half of that value could have been allocated to the machinery. The record then would have shown the very factors missing here—the total value of the assets received for the stock, and the fraction of the stock issued for the machinery.

For lack of the same essential factors the Board

of Tax Appeals decisions cited by the taxpayer (Pet. 19–24) are inapplicable.

2. The taxpayer contended below that it was entitled to a credit under Section 26 (c) (1) of the Revenue Act of 1936 (Appendix, *infra*, p. 17) on the ground that it was prohibited from paying a dividend by the express terms of a written contract executed by it prior to May 1, 1936, relating to dividends. The Board of Tax Appeals rejected the contention, holding (R. 502) that neither the taxpayer's amended certificate of incorporation nor its preferred stock certificates relied upon by the taxpayer (see Pet. 8) were a contract within the meaning of Section 26 (c) (1). The Circuit Court of Appeals rejected the contention in part; the stock certificates and certificate of incorporation, it held (R. 542–543), could be a contract, and insofar as they required payments into a sinking fund for retirement of preferred stock before any dividend could be paid on the common, they constituted a contract prohibiting the payment of dividends and entitling the taxpayer to a credit under Section 26 (c). The court held, however, that insofar as the stock certificates and certificate of incorporation required the payment of dividends on the preferred stock before dividends could be paid on the common, they did not prohibit the payment of dividends but merely provided for priorities in their payment (R. 565).

Plainly an agreement as to priority in payment of dividends is not a contract prohibiting the payment of dividends, and the Circuit Court of Appeals was correct in so holding. It is true that the decisions below and that in *Lehigh Structural S. Co.* v. *Commissioner*, 127 F. 2d 67 (C. C. A. 3d), are in conflict with *Warren Tel. Co.* v. *Commissioner*, 128 F. 2d 503 (C. C. A. 6th), certiorari denied, 317 U. S. 697 (Pet. 12–13), but that conflict cannot advance the taxpayer's case. The Sixth Circuit's decision holds that a preferred stock certificate is not a contract under Section 26 (c), and if that were followed here the taxpayer would lose even the credit which it receives under the decision below (R. 542–543, 565).

The conflict upon which the taxpayer relies already existed at the time certiorari was applied for in the *Warren Telephone* case. The Commissioner resisted the petition there because the *Warren Telephone* case was correct independently of whether the stock certificate was a contract. The provisions involved there were like the provisions here; they merely required priority in the payment of dividends. The Commissioner also resisted on the ground that the question was no longer of great importance. The pertinent statutory provisions appeared only in the Revenue Act of 1936, applicable to 1936 and 1937, and their seriousness has been abated in a large degree by the retroactive relief provisions in the amend-

ments to the Revenue Act of 1936 by Section 501 of the Revenue Act of 1942, c. 619, 56 Stat. 798. We see no further reason here why a writ of certiorari should be granted.

3. The petition (Pet. 8; cf. Pet. 14) presents no other question for review. However, the taxpayer urges error (Pet. 10, 14) in the failure of the courts below to hold that the taxpayer's redemption of 68,572 of its preferred shares held by Schroder amounted to the payment of a taxable dividend to the extent of $12.25 per share, for which the taxpayer was entitled to a dividends paid credit under Section 27 (f) of the Revenue Act of 1936. The point was disposed of by the Board adversely to the taxpayer (R. 519). It was not mentioned in the original opinion of the Circuit Court of Appeals (R. 540–554) and it was not urged by the taxpayer in its petition for rehearing (R. 555–562). The petition for certiorari states no reasons for regarding the Board's disposition as erroneous, and the question, in any event, turns upon an analysis of the facts of the transactions in 1935 and 1936 between the taxpayer and Schroder, and has no general importance.

The Circuit Court of Appeals remanded (R. 544–546) the case to the Tax Court for findings of fact appropriate to a determination of the applicability of Section 26 (g), added to the Revenue Act of 1936 by Section 501 (a) (3) of the

Revenue Act of 1942. That provision had not become law at the time the case was heard in the Board of Tax Appeals (Pet. 6, 9) and the remand was appropriate. If Section 26 (g) is applicable to the present case under the findings to be made by the Tax Court, the entire deficiencies here involved may be expunged, and the importance of the questions presented upon this petition is accordingly minimized. In any event, the question stated by the taxpayer as to the constitutionality of the undistributed profits tax in this case (Pet. 3) cannot arise until the Tax Court has determined whether there is any deficiency.

CONCLUSION

The petition presents no conflict on any question which can affect the taxpayer's case, and the petition presents no other reason for certiorari. The petition should therefore be denied.

Respectfully submitted.

CHARLES FAHY,
Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
SEWALL KEY,
ROBERT KOERNER,
Special Assistants to the Attorney General.
WALTER J. CUMMINGS, JR.,
Attorney.

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